PACIFIC EDUCATIONAL FOUNDATION, INC.
Hawai'i Job Corps

41-467 Hihimanu Street
Waimanalo, Hawaii 96795
Phone: (808) 259-6001
FAX: (808) 259-7907

500 Ike Drive
Makawao, Hawaii 96768
Phone: (808) 579-8450
FAX: (808) 579-9498

March 25, 2002

Michael T. Hill
Office of Inspector General
The Wanamaker Building
100 Penn Square East, Suite 602-B
Philadelphia, PA 19107

Dear Mr. Hill,

Enclosed is the response to the U.S. Department of Labor, Office of Inspector General Audit, draft report dated February 26, 2002.

If you have any questions about these responses please contact me at 808-259-6001.

Sincerely,

Tommy Troxell
Center Director
Hawaii Job Corps Center

CC: Sam Hunter, Executive Vice President
Lyle Perry, Senior VP &CFO
Ellie Lopez, Regional Vice President
Virleen Ferre, Director Corporate Finance
Dave Arnold, Director Corporate Finance
Allison Summers, Director Corporate Financial Services
Dan Williams, Director Internal Audit

Hawaii Job Corps Center
(Operated by Management & Training Corporation)

Responses addressing Draft Report's Findings and Recommendations

1. Excess Insurance Reserve Balances

In addressing the recommendations of this area we will address a. and then split b. into two different areas.

a. Recommendation:

We recommend that MTC prepare and submit a written plan to the Office of Job Corps which details the self-insurance policies and practices used in charging insurance costs to its government contracts. The plan should entail all of the required components of 48 CFR 28.308.

Response:

MTC concurs with the recommendation made by the auditors. However, for the record, the following historic perspective is provided.

In the early 1980's, after MTC was formed and started business, management at that time asked the Office of Job Corps how to handle several administrative matters which should have been reviewed and approved by a government Administrative Contracting Officer (ACO). Unfortunately, we cannot find any written correspondence on this matter that far back in time, but at least one individual who was involved remembers that MTC was concerned about governmental approval of fringe benefits, invoices, etc. At that time, we were told that Job Corps did not use ACO's and that we were to provide a brief description of these policies or plans in our Business Management Proposals in response to Job Corps Request for Proposals. If we were the selected bidder/contractor and awarded the contract, then our policies and plans were approved as described in our proposals. We have continued to use that practice ever since that time, and this is the first time that this practice has ever been questioned.

b. (1) Recommendation:

We recommend that the contractor modify its practices to ensure that future charges for uninsured losses be based on the present value of future payments, in accordance with the regulations.

Response:

The finding by the auditors state that "The cost accounting standards and cost principles allow contractors to charge federal contracts for the estimated self-insured losses, such as those charged by MTC". It goes on to indicate "the regulations require that if a liability will not be paid within 1 year after the loss is incurred, the amount collected for that loss must be computed as the present value of future payments …". In this particular instance the CASB 9904.416-50(a)(3) is distinguishing the "measurement of actual losses".

CASB 9904.416-50 (a)(3)(ii) states the following:

If a loss has been incurred and the amount of the liability to a claimant is fixed or reasonably certain, but actual payment of the liability will not take place for more than 1 year after the loss is incurred, the amount of the loss to be recognized currently shall be the present value of the future payments, determined by using a discount rate equal to the interest rate as determined by the Secretary of the Treasury...in effect at the time the loss is recognized. Alternatively, where settlement will consist of a series of payments over an indefinite time period, as in workmen's compensation, the contractor may follow a consistent policy or recognizing only the actual amounts paid in the period of payment.

It appears that the auditors have ignored the direction in CASB 9904.416-50 (a)(3)(ii) paragraph (1) a loss must be incurred and the amount of the liability to a claimant must be fixed or reasonably certain. Although the losses are incurred in specific periods, the claimant has up to a statutory number of years as defined by each state to file a claim, or reopen a previous claim. Thus not making the liability to the claimant fixed or reasonably certain. Once a claim has been filed, it may take a number of years to determine the appropriate treatment, and then an additional number of years to ultimately make payment on said claim. In fact, for the older years prior to 1992 and 1992, the claims exceeded the initial reserve amount, thus MTC had to hold additional funds in subsequent years to cover the shortage. Additionally, future payment of claims almost always includes a consideration for inflation, higher medical costs, increased attorney fees, and other miscellaneous expenses making a value calculated in today's dollars totally inaccurate for future payments. The amount of these claims is neither fixed nor reasonably certain, thus, calculating the present value of the future payments against the existing reserve is not applicable. However, settlement does consist of a series of payments over an indefinite time period and MTC has consistently followed an established policy of having the insurance company estimate the yearly reserves based on MTC's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

MTC along with its insurance broker meet with the insurance carrier semi-annually and reviews all claims and their status. Each claim is monitored accordingly. The bigger issue arises from the "incurred but not reported" claims. Again these claims are included in the reserve analysis based on MTC's experience, MTC's risk management program, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

Based on the above, we believe we are in accordance with the regulation. However, we are working with our insurance carrier and broker to determine if there is an acceptable way to determine a present value of such claims and will make any appropriate changes in our reserving practices.

b. (2) Recommendation:

Since the contractor has accumulated an excessive reserve balance, we recommend that the contractor set aside the funds in an interest bearing account, whereby the interest will offset the cost of further insurance charges. In addition, the contractor should determine the present value of the future payments against the existing reserve and refund any excess balance to the Federal government (the proportionate share).

Response:

The auditors came to the conclusion that the reserves were excessive and not in accordance with cost accounting standards. The insurance costs being charged and allocated are in accordance with CASB 9904.416-50 (a)(2)(i) states the following:

Except as provided in subdivisions (a)(2)(ii) and (iii) of this subsection, actual losses shall not become a part of insurance cost. Instead, the contractor shall make a self-insurance charge for each period for each type of self-insured risk which shall represent the projected average loss for that period. If insurance could be purchased against the self-insured risk, the cost of such insurance may be used as an estimate of the projected average loss; if this method is used, the self-insurance charge plus insurance administration expenses may be equal to, but shall not exceed, the cost of comparable purchased insurance plus the associated insurance administration expenses. However, the contractor's actual loss experience shall be evaluated regularly, and self-insurance charges for subsequent periods shall reflect such experience in the same manner as would purchased insurance. If insurance could not be purchased against the self-insured risk, the amount of the self-insurance charge for each period shall be based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.

MTC is in accordance with CASB 9904.416-50 (a)(2)(i), "if insurance can be purchased against the self-insured risk, the cost of such insurance may be used as an estimate of the projected average loss". MTC's yearly estimated reserve amount booked is significantly lower than if insurance was purchased for the self-insured risk.

CASB 9904.416-50 (a)(2)(i), also states that, if insurance could not be purchased against the self-insured risk, the amount of the self-insurance charge for each period should be based on the contractor's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles. MTC's estimated reserve amount is calculated by the insurance company and is based on MTC's experience, relevant industry experience, and anticipated conditions in accordance with accepted actuarial principles.
It also appears that the determination of the reserve being excessive is due to its increase.
From 1992 to 2000 MTC's business has grown and revenues have increased from $175,046,845 to $321,773,864, respectively. This is an increase in business of $146,727,019 or 83.82%. Thus, it would be reasonable that MTC's reserve balance would also increase from 1992.

Due to the fact that claims which occur in a particular year may not be filed until subsequent periods, and most likely will not be settled and/or paid for many more years, 1992 is the only year that appears to have the majority of the applicable claims paid by 2000. Thus, using 1992 as a base year and estimating future claims based on 1992 actual claims paid ($1,455,529) to revenue ($175,046,845) the following reserve estimates were calculated:

Year	Revenue Per Audited F/S	Revenue % Increase From From 1992	Estimated Based on 1992 Revenue Increase	Total Reserve Collect by Year
1993	187,540,063	7.14%	1,559,454	1,200,000
1994	195,021,742	11.41%	1,621,605	1,337,740
1995	222,505,574	27.11%	1,850,123	1,796,304
1996	240,799,277	37.56%	2,002,226	1,821,358
1997	241,854,355	38.17%	2,011,104	1,874,530
1998	253,934,267	45.07%	2,111,536	1,950,733
1999	285,650,403	63.19%	2,375,278	1,859,000
2000	321,773,864	83.82%	2,675,553	2,568,500

The data above reflects the fact that the total reserve collected in any given year is less than the estimated reserve. Based on the above calculations, and the fact that MTC's yearly estimated reserve amount booked is significantly lower than if insurance was purchased for the self-insured risk, MTC believes its reserve account balance is reasonable, but we will continue to evaluate this with our insurance carriers and consultants to ensure we are meeting all of the applicable FAR and CAS requirements.

Another mitigating factor in the appearance of excessive reserves is that for the policy year 2000 (October 2000 through September 2001), the costs of the insurance had not been expensed to the contracts. Approximately one quarter of those costs would have been expensed as of December 31, 2000 when this was reviewed, and therefore both asset and liability are grossing up the balance sheet.

Additionally, MTC was required to pay a portion of the reserve to the insurance company upfront for claims. It was not until recent years that the insurance company has agreed to accept a Letter of

Credit (LOC) in lieu of the upfront reserve payments. The amount of the LOC as of 2000 was $4,300,000.

Overall, the insurance is very complicated and we do not believe that the conclusions reached are valid.

2. Weak Controls Over Construction and Rehabilitation Projects

a. Recommendation:

We recommend that MTC implement improved controls over the CRA funding provided to the HJCC. These controls should ensure:

1. Adequate accountability over the CRA funds awarded;
2. adequate tracking and monitoring for timely completion,
3. advance approval of re-directed funds prior to expenditure of such funds for an alternative project, and
4. improved procedure for documenting receipt of goods or services prior to payment.

Response:

We concur with the auditor's recommendation. The current Financial Services Manager is monitoring funding of CRA and tracking progress of projects. On a monthly basis, a construction/rehab report is completed, and on a quarterly basis it is submitted to the Regional Office and National Office for review. This report shows progress of all projects funded. In addition, the Financial Services Manager is working closely with the Regional Project Manager to ensure funding is received prior to expenditures of funds. Prior to payment to vendors, all invoices are reviewed by the Financial Services Manager to ensure authorization of payment is evident with signatures of individuals monitoring project.

b. Recommendation:

In addition, we recommend that the HJCC adjust its ETA 2110 report to reflect accurate CRA and operations' costs. As of June 30, 2001, the necessary adjustment was $31,980.

Response:

We do not completely concur with the auditors recommendation. Funding was received in the amount of $145,020 and was referenced to the May 1998 Maui Facility Survey. No supporting documentation was received or could be obtained from the Regional office regarding the required projects to be completed. The Financial Services Manager, Maui Site Manager and Maui Maintenance Supervisor reviewed every project in the survey to identify what projects had been completed. The cost of competing these projects was an estimate based on the cost in the facility survey. We are currently in the process of identifying the invoices to support the completion of the projects. Once we have identified the invoices to support the completion of the projects, and verify where recorded, the amount will be moved to construction/rehab. The Financial Services Manager has taken step to accurately track funds based on projects.

3. Accountability Over Inventories

1. Recommendation:

We recommend that complete perpetual inventory records are maintained which provide sufficient detail (description, quantity and value) of the items held in inventory at the end of each reporting period. The balances reflected on the report should support the inventory balances reported on the ETA 2110.

Response:

We do not completely agree with the auditor's findings and recommendations. The computerized inventory system used by Hawaii Job Corps Center does generate a detailed listing of recorded inventory balances. The HJCC staff discussed with the auditor the process in which inventories are generated. During the month-end close process there is a report that provides detail including item, number on hand, unit price, extended value and total inventory. In the past, the reports were ran to include totals only, not detailed information. Effective immediately, this report will be generated to include details of inventory to document and support inventory balances on the ETA 2110 reports.

2. Recommendation:

We also recommend that MTC take greater care in maintaining records and in reporting these items on the ETA 2110 to ensure that the reports are accurate, complete, and up to date.

Response:

We concur with the auditor's recommendation. Significant variances in medical inventories was due to the manual process of maintaining this inventory. On September 1, 2001, the medical and dental supplies were put on the Lawson inventory system (computerized). This computerized inventory system will allow management the opportunity monitor receipts and issues of inventory items.

The Financial Services Manager has taken greater care in ensuring inventories recorded on the ETA 2110 are accurate, complete and up to date.

4. Journal Entries Not Reviewed

Recommendation:

We recommend that the center initiate procedures which require that journal entries be reviewed and approved by someone other than the preparer. This process should be documented by initialing and dating the appropriate line on the journal entry form.

Response:

We agree with the auditor's finding and recommendation. All journal entries will be reviewed by an accounting position other than the staff entering the journal entry. These positions have been trained on what to review to ensure that financial records are free from errors or irregularities.

5. Vacation and Sick Leave Balances Exceed Corporate Limits.

Recommendation:

We recommend that MTC review the leave balances for center staff and determine whether a portion of these balances should be forfeited by the respective employees. We also recommend that MTC ensure that the policies applicable to the HJCC are clarified and, if unique to HJCC, put into writing and re-issued to all center staff.

Response:

We do not completely concur with the auditor's findings or recommendations. We will address the recommendation of this area by separating Vacation Balances and Sick Leave Balances as these are two separate policies.

<u>Vacation Balances</u>

MTC reviews vacation balances on an annual basis. Employees may carry over an amount of vacation that does not exceed the employee's annual allowed accrual maximum. This amount is a sliding scale based on tenure. Any excess hours must be used by no later than the cut-off date covered by the second paycheck in January. Any excess hours remaining after that date will be lost and the vacation balance is adjusted down to his/her maximum annual allowed accrual.

Per MTC policies (No. 310.52), the maximum vacation balance applies to what may be **carried over** from year to year, not to set a limit on the available balance of vacation. The maximum balance does **not** mean that employees cannot continue to accrue vacation hours over and above that carryover balance during the year. At any given time during the year, an employee's vacation balance might exceed the maximum carryover limit. Employees have the opportunity to use their vacation throughout the year. The policy is in place to ensure that any excess vacation (amount above carryover) remaining at the end of each year is lost.

Sick Leave Balances

MTC has a provision in the subcontract agreement dated February 6, 1986 with Pacific Educational Foundation, Inc. that allows for sick leave balances in excess of the corporate limit for employees who had been employed prior to MTC's acquisition of the contract. We have identified these grandfathered employees and will maintain their accruals separately from all other employees. No further accruals will occur for these employees until their sick leave balance drops below the corporate limit of 240 hours.

All other balances have been reviewed and any that are above the 240 limit will be adjusted accordingly. Measures have been developed to ensure that no accruals will occur beyond the 240 hour limit.